

July 21, 2020

Via Email (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Valuation Rule 2a-5; Investment Company Act Rel. No. 33845
(the "*Proposing Release*"); File No. S7-07-20

Dear Ms. Countryman:

First Trust Portfolios L.P. ("*First Trust*") is a registered broker-dealer and a sponsor to unit investment trusts (collectively, the "*UITs*" and each a "*UIT*"). Established in 1991, First Trust has sponsored thousands of unit investment trusts ("*First Trust UITs*"). Since its founding, First Trust has deposited over 11,700 trusts. We appreciate this opportunity to provide comments on behalf of First Trust to the United States Securities and Exchange Commission (the "*Commission*") on the Commission's proposed new Rule 2a-5 (the "*Proposed Rule*") under the Investment Company Act of 1940 (the "*Act*") that would provide requirements for determining fair value in good faith with respect to a fund for purposes of Section 2(a)(41) of the Act. Under the Proposed Rule, the Commission proposes, among other things, that in the case of UITs, the trustee of the UIT would conduct the fair value determinations under the Proposed Rule. In the release proposing Rule 2a-5 (the "*Proposing Release*")¹, the staff requests comments, among other things, as to whether an entity other than the trustee should perform the various valuation functions, whether the trustee should be permitted to assign these determinations to another, whether the trustee should have oversight responsibilities, and whether other modifications to the Proposed Rule would be appropriate. As outlined below, we believe that the Proposed Rule should have the flexibility to permit a UIT to utilize the evaluator specified in its trust indenture (or party performing similar functions as set forth in the trust indenture) which may be the trustee, depositor, an affiliate of the depositor or trustee or a third party service provider unaffiliated with the trustee or depositor provided such third party service provider is under the oversight of the trustee, depositor or an affiliate of the depositor to perform the valuation functions of paragraph (a) in the Proposed Rule. Further, we believe that existing UITs should be excluded from the Proposed Rule's requirements as detailed below.

¹ See Good Faith Determinations of Fair Value, Investment Company Act Rel. No. 33845 (April 21, 2020) (*i.e.*, the *Proposing Release*).

I. Background of UITs and Current Valuation Practice

Section 4(2) of the Act defines a UIT as an investment company that (1) is organized under a trust indenture or similar instrument, (2) does not have a board of directors, and (3) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities. Section 2(a)(41) of the Act further requires funds to value their portfolio investments using the market value of their portfolio securities when market quotations are readily available and when a market quotation is not readily available, by using the fair value of the securities “as determined in good faith by the fund’s board.” The section therefore does not address how UITs should value their assets since UITs do not have a board of directors. Accordingly, it is the trust indenture which is the governing document that sets forth the duties of the various parties connected with the organization and operation of the UIT (generally including, but not limited to, the trustee, depositor, evaluator, and portfolio supervisor) and, in relevant part, sets forth the party who will be responsible in valuing the assets and the manner in which the assets will be valued.

With respect to the valuation of assets of a First Trust UIT, the evaluator designated in the trust indenture is responsible for valuing the assets held in the portfolio and furnishing such valuations, among others, to the trustee. In the case of the First Trust UITs, the evaluator is First Trust Advisors L.P., an affiliated person of First Trust (“*First Trust Advisors*”). First Trust Advisors is a registered investment adviser and has the expertise, the resources, and capabilities in the First Trust complex to perform the valuation duties. Although an affiliate of the depositor serves as the evaluator for the First Trust UITs, we understand that other UIT sponsors may utilize other entities to serve as the evaluator for their UITs, including the trustee, depositor or a third party service provider.² If First Trust Advisors resigns or is removed as evaluator, the trust indenture for the First Trust UITs also provides the manner in which a successor is appointed (*e.g.*, by the trustee and/or depositor). In addition to setting forth the entity responsible for the valuation of the UITs’ assets, the trust indenture also provides the methodology in which the assets shall be valued by the evaluator.³

² We recognize that some UIT trust indentures do not specifically name an evaluator but rather the indentures may assign such valuation functions to the respective party (*e.g.*, the trustee) without labeling them as evaluators.

³ For example, the trust indenture for the First Trust UITs provides, in relevant part, that for securities listed on a national or foreign securities exchange or The Nasdaq Stock Market, such evaluation shall generally be based on the closing sale price on the exchange or system which is the principal market therefore (the “*Primary Exchange*”) (unless the evaluator deems the price inappropriate as the basis for evaluation); if no closing sale price of the Primary Exchange is published, then the evaluation is based on the last trade price on the Primary Exchange; if no trades occurred on the Primary Exchange for a specific trade date, the evaluation will be based on the closing sale price from, in the opinion of the evaluator, an appropriate secondary exchange, if any. If no trades occur on the Primary Exchange or any appropriate secondary exchange on a specific trade date, the evaluator will determine the evaluation using the best information available to the evaluator which may include the prior day’s evaluated price. If securities are not so listed or, if so listed and the principal market therefor is other than on the Primary Exchange or any appropriate

II. Treatment of UITs under Proposed Rule 2a-5

Under the Proposed Rule, if a fund is a UIT, the fund's trustee must carry out the requirements of paragraph (a) of this section. We believe the imposition of these duties solely on the trustee may be inconsistent with current industry practice and with the approach taken in similar rules in addressing UITs. More specifically, as noted, Section 2(a)(41) does not address the approach an investment company without a board of directors should follow to value its portfolio holdings. Accordingly, as industry practice developed, UITs have utilized an evaluator designated in the trust indenture or if none is designated, the indenture will assign the duties to an entity, such as a trustee. As noted, First Trust UITs utilize First Trust Advisors, an affiliate of the depositor, to serve as its evaluator but other UIT complexes may utilize the trustee, depositor or a third party service provider to perform the valuation responsibilities as appropriate for their complex. First Trust UITs uses First Trust Advisors because, among other things, it is a registered investment adviser with the resources and expertise in the organization to perform such valuation functions for the UITs. In the performance of its duties, First Trust Advisors may hire a pricing service to help provide prices for securities of a UIT, subject to initial due diligence and continuing oversight. In addition, under the terms of the trust indentures for the First Trust UITs, the trustee of the First Trust UITs generally may rely on the evaluations furnished by First Trust Advisors, and the trustee has no responsibility for the accuracy thereof. Similarly, we understand that some UITs may utilize, among others, a third party service provider unaffiliated with the trustee or depositor for certain of their UITs as such service provider may have the better expertise and resources to perform the respective valuation functions.

We note that the staff in the Proposing Release, appears to select the trustee to conduct fair value determinations, in part, due to Form N-7, Appendix B, Guide 2 (March 17, 1987) which indicates that the board's fair value role under Section 2(a)(41) is to be performed by the UIT's trustee "or the trustee's appointed person". In this regard, Form N-7 was only re-proposed and never adopted and therefore the proposal would not have reflected any additional comments received. Nevertheless, the guidelines as proposed provided the flexibility that the trustee could appoint another. We believe the Proposed Rule should be revised to permit a UIT to utilize the evaluator specified in the trust indenture (or the party performing similar functions as an evaluator if no evaluator is specified in the trust indenture) which may be the trustee, depositor, an affiliate of either or a third party service provider unaffiliated with the trustee or depositor provided such third party service provider is under the oversight of the trustee, depositor or an affiliate of either to perform the valuation functions of paragraph (a) in the Proposed Rule as well as any successor

secondary exchange, the evaluation generally will be based on the current ask price on the over-the-counter market (unless the evaluator deems such price inappropriate as a basis for evaluation). If current ask prices are unavailable, the evaluation is generally determined (a) on the basis of current ask prices for comparable securities, (b) by appraising the value of the securities on the ask side of the market or (c) the combination of the above.

thereto if the original evaluator resigns or is terminated as set forth in the terms of the trust indenture.

We further believe that permitting the depositor, an affiliate of the depositor or trustee or an unaffiliated third party evaluator to perform the valuation functions would be consistent with the approach the staff has taken in addressing UITs in other rules. For instance, in the recently adopted liquidity rule 22e-4, the SEC adopted a limited review requirement for UITs pursuant to which the UIT's *principal underwriter or depositor* must determine, on or before the initial deposit of portfolio securities into the UIT, that the portion of the illiquid investments that the UIT holds or will hold at the date of deposit that are assets is consistent with the redeemable nature of the securities it issues. In addition, the Proposing Release recognized that Rule 38a-1 requires a fund to adopt compliance policies and procedures and that such rule would apply to a fund's obligations under the proposed Rule 2a-5. Under Rule 38a-1, the fund's principal underwriter or depositor must approve the fund's policies and procedures and chief compliance officer, must receive all annual reports and must approve the removal of the chief compliance officer from his or her responsibilities.

Similar to these rules, we believe that the Proposed Rule should have the flexibility to permit the valuation functions to be performed by the trustee, depositor, an affiliated person of the either or a third party service provider unaffiliated with the trustee or depositor but subject to oversight by the trustee, depositor or affiliate of either. Although Rule 22e-4 and 38a-1 only reference the principal underwriter or depositor, we recommend adding affiliates thereof because, as noted above, the UIT complex, such as the First Trust UIT complex, may have a structure in which the affiliated person is a registered investment adviser and the expertise and resources for valuing assets may be housed with that entity. Further, some UIT complexes may utilize the resources and expertise of a third party service provider unaffiliated with the depositor or trustee to perform the valuation functions in which case such service provider shall be subject to the oversight of the trustee, depositor or affiliated person of either. We see no reason to deviate from and disrupt the established practice of the First Trust UITs (as well as that of other UIT complexes) and require the valuation functions or oversight thereof to be assigned to the trustee which may not have traditionally performed such role for the respective UITs, may not have the expertise to step into such role and may not be willing to commit the resources necessary to develop such expertise. In this regard, as noted above, the trustee of the First Trust UITs does not perform the valuation responsibilities for the First Trust UITs but rather uses the valuations provided by First Trust Advisors to calculate the respective UIT's unit value. Given the multitude of trusts that First Trust deposits each year, First Trust is concerned that the trustee would not be capable or willing to take on the valuation responsibilities or any valuation oversight functions that it has not traditionally performed under the terms of the trust indenture.

We further recognize that UITs do not raise the same level of conflict of interest with respect to valuation as confronted by managed funds. More specifically, UITs are unmanaged and

do not have advisers whose advisory fee is based on assets under management which may create an incentive to overvalue the portfolio holdings to obtain a larger fee. As the evaluator, First Trust Advisors is compensated based on the number of units (and not the value of the trust's net assets), and its compensation as evaluator is subject to the at-cost provisions of Rule 26a-1 of the Act. Further, we note that UITs, given their fixed term, rarely hold Level 3 securities which further limits the UITs' valuation risks. Accordingly, we do not believe that UITs require the same level of oversight as in the case of an investment adviser performing the valuation functions.


In addition to the foregoing, as noted above, the trust indenture sets forth the duties of the various parties which organize and operate the UIT, including with respect to valuation, and the methodology to be followed in valuing the UIT's assets. As UITs have a finite term, it would be unnecessarily disruptive and expensive to modify the UITs' existing practice.

Further, as written, the Proposed Rule notes that a fund's trustee must carry out the requirements of paragraph (a) of the rule. The Commission should make clear that the requirements of paragraph (b) of the rule are not applicable to UITs.

We appreciate the opportunity to comment on the Proposed Rule. If we could provide additional information, please call the undersigned at (630) 765-8798.

Sincerely,

FIRST TRUST PORTFOLIOS L.P.

By: 
W. Scott Jardine
General Counsel